



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE – EO Mandatory Review
1100 Commerce Street, MC 4920-DAL
Dallas, TX 75242

Release Number: **200840048**

Release Date: 10/3/08

Date: May 29, 2008

UIL Code: 501.03-01

Legend

ORG = Organization name

ORG

ADDRESS

XX = Date

Address = address

Employer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer To:

TE/GE Review Staff

**LAST DAY FOR FILING A
PETITION WITH TAX COURT:**

August 27, 20XX

CERTIFIED MAIL

Dear

This is a Final Adverse Determination revoking your exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

ORG has failed to provide evidence you are currently operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not a charitable organization within the meaning of Treasury Regulations 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. We determined that your activities fail to accomplish one or more of the exempt purposes specified in IRC 501(c)(3), yet your activities confer a substantial private benefit upon your officers; therefore, you do not operate exclusively for exempt purposes.

Based upon the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code retroactively to January 1, 20XX.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax return Form 1120. These returns should be filed with the appropriate Internal Revenue Campus for the year ending December 31, 20XX and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax exempt status was determined by calling _____, faxing _____, or writing to: Internal Revenue Service, Taxpayer Advocates Office.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals process, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	
Name of Taxpayer ORG		Year/Period Ended 20XX12

LEGEND

ORG = Organization name XX = Date XYZ = State City = city
 President = president Vice-President = Vice-president Secretary =
 secretary CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8, CO-9, CO-10, CO-
 11 & CO-12 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th, & 12th
 companies.

Issue:

Whether ORG continues to qualify for exemption under Internal Revenue Code section 501(c)(3).

Facts:

ORG [ORG] is a XYZ non-profit corporation operating a bingo hall in City under the name CO-1. In addition to traditional paper bingo, the hall offers electronic video bingo, pull tabs, and incidental bingo gear for sale (daubers and hats).

Currently ORG has four employees and three officers who work in the bingo hall. President lives in City, XYZ, but visits City in the summer to help. Secretary (formerly Secretary) lives in City, XYZ, but drives to City to assist when needed. Vice-President (incorrectly listed as a Member on the 20XX Form 990) lives in City. All three officers and regular employees are compensated for their work in the bingo hall.

In the year under examination (calendar year 20XX), ORG had approximately 80 employees in numerous bingo halls throughout the state of XYZ: City, City, City, City, City, City, and two sites in City.

Over the years, ORG has donated money to various charitable organizations, had holiday food and toy drives, opened the bingo hall to children for cookies and hot chocolate after a winter parade, had a bake sale and a quilt giveaway to raise funds for a high school student traveling overseas and given turkeys to bingo players.

Application for Exemption and Determination File:

On April 1, 19XX, ORG submitted a Form 1023, Application for Recognition of Exemption, to the Internal Revenue Service stating that:

1. The primary function of the ORG is fund-raising for the benefit of other non-profit organizations. At present, our main activity is the operation of a Public Bingo Parlor. Currently, 80% of the corporation's efforts go toward the operation of the bingo parlor. The bingo parlor is open 6 days a week, and is operated by the employees of the corporation.

Funds have been used to sponsor the following activities:

Chamber of Commerce Boom Town Days ping pong ball drop Bowling participants in fund-raiser for muscular dystrophy CO-2 Tournament Team Members of CO-3 All-State Marching Band from City and CO-4 CO-5

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In addition to fund-raising, ORG operated a fall food drive for other non-profit organizations, a toy drive in connection with program, and a turkey give-away with a local supermarket.

Proposed future activities include raising funds for CO-6, sponsoring fund-raisers for the local Soup Kitchen, and making annual contributions to charitable organizations.

It is our plan to distribute our proceeds annually to other non-profit organizations.

2. Our financial support is the income from the operation of the bingo parlor.

In response to the Internal Revenue Service's request for further information and clarification in a phone conversation on October 28, 19XX, President and Secretary (then Secretary) wrote to the IRS in a letter of the same date, among other statements:

We anticipate giving between 5 and 10% of our gross receipts for this year and the comings[sic] years to similar [charitable] organizations.

I did not understand until our conversation that pull tab income and bingo income should be kept separate [sic]. We estimated 5% of our gross income was from pull tabs... We will keep pull tab income from this day on separate[sic] from bingo income... I understand that we will be taxed on the pull tab income.

On February 11, 19XX, the Internal Revenue Service sent ORG Letter 1045, stating that ORG was exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501 (c)(3). The organization was told to let the IRS know if there was a change in support, purpose, character, or method of operation.

Although ORG stated in its application for exemption that it was going to operate a bingo parlor (singular), it did not inform the IRS when it expanded its operations to nine bingo parlors.

ORG Bylaws and Directors' Minutes:

ORG was organized as a public benefit non-profit corporation under the XYZ Nonprofit Corporation Act on June 11, 19XX.

Section 1.3 of ORG's bylaws states "the corporation shall have no members". ORG's Form 990 for 20XX lists Vice-President and as "members". The 20XX Form 990 lists Vice-President as "member". The 20XX Form 990 lists Vice-President as "member".

Section 6.2 of ORG's bylaws states "the fiscal year of the corporation shall be the calendar year, beginning on June 1 and ending on May 31 of the following year." ORG has maintained its books and filed its tax returns based on calendar years, January through December.

On January 27, 20XX ORG's bylaws were amended at Section 7.1 to state: The corporation shall distribute funds from net profits from each and every operation to local non-profit, tax exempt organizations located in the county in which each operation is located. By way of example, all revenues

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generated in City by the City operation will be distributed to non-profit, tax-exempt organizations located in City and all revenues generated in City by the City operation will be distributed to non-profit, tax-exempt organizations located in City.

Minutes of the January 27, 20XX, board of directors' meeting reflect that Vice-President was elected as ORG's vice-president.

Filing of Internal Revenue Service Returns:

ORG has filed required Forms 990, Return of Organization Exempt from Income Tax for calendar years ending December 31; Forms 940, Employer's Annual Federal Unemployment (FUTA) Tax Return; Forms 941, Employer's Quarterly Federal Tax Return and Forms W2-G, Certain Gambling Winnings when single bingo prizes of at least \$ or pull tab prizes of at least \$ were awarded. No Forms 945, Annual Return of Withheld Federal Income Tax have been filed, as no regular gambling withholding was required, as there have been no prizes greater than \$.

ORG has never filed a Form 990-T, Exempt Organization Business Income Tax Return.

After the week of September 24, 20XX, during which the IRS examiner explained excise taxes, ORG began filing Forms 11-C, Occupational Tax and Registration Return for Wagering, and Forms 730, Monthly Tax Return for Wagers.

ORG Activities:

As noted above, ORG's application for exemption stated that its main activity was raising funds for other charitable organizations by running a bingo hall.

ORG Gaming activities:

From 19XX until the beginning of 20XX, ORG ran traditional paper bingo games and sold pull tabs. In traditional bingo, players purchase bingo cards containing numbers which are to be matched in various patterns against numbers on balls drawn randomly from an air hopper. The numbers are called. Players mark the called numbers on their card. Players call "bingo" when they match the same pattern on their card. First "bingo" wins the game's prize.

In 20XX, ORG continued the above activities, but also introduced video bingo, which utilizes electronic bingo game hardware and software. Video bingo differs from traditional bingo in several respects: there is not a winner for every game; players do not compete against other players; no skill is involved; the "cards" are computer generated by the machine after the numbers have been entered, thus creating the opportunity for result manipulation. There is no way for the player to observe the selection of his "card".

ORG continued to offer pull tabs, traditional paper bingo, and video bingo until , 20XX, when a XYZ District Court determined that video bingo was illegal in the state of XYZ.

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From January, 20XX until July, 20XX, ORG offered only traditional bingo and pull-tabs. In , 20XX, video bingo was made legal in the state of XYZ and ORG resumed offering video bingo games. However, ORG is not currently providing video bingo to its patrons.

ORG Charitable activities:

On its 20XX Form 990, ORG shows \$ in charitable donations. This amount is less than 2% of ORG's reported receipts of \$.

ORG had no written verification from any IRC 501(c)(3) organization confirming the donations. ORG provided a spreadsheet showing a total of \$ in donations for 20XX, but could not tie this amount to its records and could not explain why this amount was not on its Form 990 (which was filed using the cash accounting method). Cancelled checks for \$ were offered as substantiation, but some of the payees (such as) were not verified 501(c)(3) organizations. Other payees, such as CO-7 and CO-8 did not substantiate charitable use of the funds. Checks to the and similar organizations are not charitable donations; such organizations [IRC 501(c)(4 through 20) may be tax exempt, but funding them is not a charitable donation.

Copies of Forms 990 show no financial donations made in 20XX ("gross" receipts of \$), and \$ contributed in 20XX ("gross" receipts of \$).

During the initial interview conducted on September 25, 20XX, Secretary stated that in previous years ORG had holiday food drives, letting customers who donated canned food play a free card of bingo. However, in 20XX and 20XX there was no such activity.

In a letter to the IRS dated November 8, 20XX, Secretary went on to state: I do not believe we had a can[sic] food drive in 20XX, we donated cash instead. 20XX was the year after the XYZ Supreme Court ruling and it was difficult to keep the bingo hall operational and 20XX we started back on our feet and then Vice-President got sick, but we still provide our bingo hall every year around the 1st of December to CO-9. They have a winter parade and we open our doors for the young children to enter and have cookies, hot chocolate, this year the Date is December 1st, 20XX. We are also giving 50% of our ORG

Bingo Game the Letter H proceeds and purchasing toys for children for CO-9. Vice-President says we also purchased turkeys in 20XX and gave to our bingo players. Vice-President got very ill in 20XX and we did not do much of any giving that year. Presently we have donated to the soup kitchen and senior citizens, toy drive for CO-9, and had a bake sale and quilt giveaway for an individual high school student to travel to a different country.

ORG contract with related party:

On January 4, 20XX, President, President, ORG ("Licensee"), signed a software license and hardware lease agreement with CO-10 ("Licensor").

Whereas Licensor is the owner and developer of a video bingo software product known as "Video Bingo" which along with the hardware (the "System") Licensor agrees to license and lease to Licensee in accordance with the terms and conditions provided herein...

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Licensee agrees to pay Licensor a licensing fee and lease fee (the "use fee") for the use of the System. This use fee shall be cents per card played per day.

This signed agreement never defined the cost of the licensing fee.

Secretary stated that there were no written amendments to this contract with CO-10, but in fact, cents per card was not paid to CO-10. Rather, CO-10 received 50% of all gross receipts received for video bingo games sold by ORG.

CO-10, is owned 50% by CO-11 and 50% by CO-12. CO-11 is owned by Owner-CO-11, an individual not related to ORG. CO-12 is owned 33 1/3% each by President, Secretary, and Vice-President, officers of ORG.

ORG Records:

Although Secretary assured the IRS that pull-tab income would be kept separate from bingo income in her letter of October 28, 19XX, to the Determinations agent, in fact, pull-tab income was not tracked separately.

In her letter to the IRS of November 8, 20XX, Secretary estimates that pull tab receipts were 5% of ORG's annual gross income and she provided the following:

Year	Gross Income	Pull-Tab Receipts
XX		
XX		
XX		
XX		
XX		
XX		
XX		
XX		
XX		
XX		

It should be noted, that although Secretary indicates the amounts are "gross income" for the above years, the amounts are in fact net of prizes paid to bingo and pull-tab winners. On all Forms 990 filed by ORG, the line L "gross receipts" is incorrect; the number is gross receipts less prizes paid out, or "net receipts". ORG's records are such that actual gross receipts could not be reconstructed.

For 20XX, gross receipts of \$ are reported on the Form 990; this is \$ of program service revenue (bingo and pull tab receipts) and \$ of interest. The 20XX Form 990 also shows \$ of "professional fundraising fees" on line 30 of Part II, Statement of Functional Expenses. On Schedule A, Part II, Compensation of the Five Highest Paid Independent Contractors for Professional Services, CO-10 is shown as having been paid \$ for "fundraising". As Secretary affirmed, and records indicate, CO-10 was in fact paid 50% of

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video bingo gaming receipts. This indicates that gross receipts for video bingo were \$ (2 times the CO-10 fee of \$). This leaves \$ (\$ less \$) of net receipts for regular bingo games, pull tabs, and miscellaneous sales of daubers and bingo gear. These numbers fail to reconcile with what is shown in the books and Secretary's November 8, 20XX, statement showing 20XX pull tab income of over \$.

XYZ Law:

The state of XYZ permits bingo and pull-tab games to be operated only by public benefit non-profit exempt organizations, whose licenses must be annually renewed.

On , 20XX, the XYZ District Court determined that video bingo was not permitted under XYZ state law. Subsequent XYZ legislative action permitted video bingo beginning 20XX.

Closing Conference:

An Examination closing conference was held at the IRS office in City, XYZ, on March 19, 20XX. Ms. Secretary, Secretary of ORG, IRS Manager of EO Group , and Revenue Agent Group were in attendance. At that time Secretary said she was in disagreement with some of the facts presented in the 886-A and she needed to review the situation. Subsequently, Secretary said the EO would agree to revocation.

Law:

Section 501(c)(3) of the Internal Revenue Code (IRC) provides for the exemption from federal income tax of organizations which are organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (T.R.) provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code in order to be exempt as an organization described in such section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in IRC section 501(c)(3) in its generally accepted legal sense.

Section 1.501(c)(3)-1(e) of the regulations states that an organization may be exempt under section 501(c)(3) even though it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization's exempt purposes and if the organization is

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not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the facts and circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

IRC Section 512(a)(1) defines the term "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business.

IRC Section 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt purposes.

IRC Section 513(a)(1) provides that the term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

IRC Section 513(f) provides that the term "unrelated trade or business" does not include the conduct of certain bingo games.

IRC Section 513(f)(2) defines "bingo games" as any game of bingo of a type in which usually the wagers are placed, the winners are determined, and the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game, the conducting of which is not an activity ordinarily carried out on a commercial basis, and the conducting of which does not violate any State or local law. Section 1.513-1(e)(1) of the Income Tax Regulations provides for exceptions to section 513(a) of the Code, including any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.513-5(a) of the regulations provides that, under section 513(f) of the Code, and subject to the limitations in paragraph (c) of this section, in the case of an organization subject to the tax imposed by section 511, the term "unrelated trade or business" does not include any trade or business that consists of conducting bingo games as defined in paragraph (d) of this section.

Section 1.513-5(c)(1) of the regulations provides that paragraph (a) of this section shall not apply with respect to any bingo game conducted in violation of State or Local law.

Section 1.513-5(d) defines a bingo game as

A game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "bingo game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

Section 53.4942(b)-1(a)(2)(ii) defines "engage primarily" as at least 50 per cent.

The group of individuals that may properly receive assistance from a charitable organization is called a *charitable class*. A charitable class must be sufficiently large or indefinite that the community as a whole rather than a pre-selected group of people is benefited.

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Rev. Rul. 64-182, 1964-1 C.B. 186, (Part 1), describes an organization that derived its income principally from the rental of space in a large commercial office building that it owned, maintained, and operated. The revenue ruling holds that the organization meets the primary purpose test of section 1.501(c)(3)-1(e) of the regulations because its charitable contributions are commensurate in scope with its financial resources and are in furtherance of its exempt function. Thus, an organization whose principal activity is operating tax exempt bingo games may nevertheless qualify for exemption, provided it uses the proceeds of that business activity in a real and substantial charitable program [such as charitable grant making] commensurate in scope with its financial resources.

Rev. Rul. 80-287, 1980-2 CB 185 The organization operated a nonprofit lawyer referral service that arranged for any member of the public to visit a lawyer whose name is on an approved list maintained by the organization for a nominal fee. After the initial appointment, any additional services performed by the attorney are governed by a normal lawyer-client contractual relationship with which the organization has no connection. Although the organization provided some public benefit, a substantial purpose was promoting the legal profession. Therefore, it was not exempt under IRC section 501(c)(3).

In *Make a Joyful Noise, Inc. vs. Commissioner*, T.C. Memo 1989-4, 56 T.C.M 1003 (1989)[CCH Dec. 45,405(M)], it was ruled that an organization that conducted bingo games to support a camp for disadvantaged children and elderly citizens was not exempt under *section 501(c)(3) of the Code* because evidence showed that the organization had not made any progress toward the achievement of its charitable goals; and the organization was engaged in the conduct of bingo games.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974)[74-2 USTC P9816], holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact. See also *Christian Stewardship Assistance, Inc. v. Commissioner*, 69 [70] T.C. 1037[CCH Dec. 35,422], 1042 (1978).

In *Help the Children, Inc. vs. Commissioner*, 28 T.C. 1128 (1957)[CCH Dec. 22,552], the court denied exemption under *section 501(c)(3) of the Code* to an organization that made most of its money from bingo receipts and turned over a small percentage of those receipts to charity.

Better Business Bureau v. United States, 326 U.S. 279, 66 S. Ct. 112, 90 L. Ed. 67 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under *section 501(c)(3)*. An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such purposes.

In *Haswell v. United States*, 500 F.2d 1133 (Ct.Cl. 1974), "substantial activities" was determined to be at least 16 to 20% of an organization's activities.

Government's Position:

ORG is not being operated exclusively for charitable purposes and its net earnings are benefiting its corporate officers.

IRC Section 501(c)(3) provides for the exemption from federal income tax of organizations which are organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

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ORG Operations:

T.R. section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in IRC section 501(c)(3). It further provides that an organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Bingo is not a charitable activity:
Bingo itself does not accomplish one or more of the exempt purposes specified in IRC section 501(c)(3).
Bingo income may provide funds for charitable activities, but fundraising is not a charitable activity, as it does not accomplish one or more the exempt purposes specified in IRC section 501(c)(3).

The total gaming winnings paid to bingo and pull tab players is not known, but none of whatever this amount is can be attributed to charitable activities, as bingo in itself is not a charitable activity.

Majority of activities were taxable:

Section 1.501(c)(3)-1(e) of the regulations states that an organization may be exempt under section 501(c)(3) even though it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization's exempt purposes and if the organization is not organized or *operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513*. In determining the existence or nonexistence of such primary purpose, all the facts and circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

Video bingo, pull tabs, and bingo gear sales are not exempt from tax under IRC 513(f) because they do not meet the description of tax exempt bingo at Section 1.513-5(d) of the regulations.
Traditional paper bingo, with numbers being called and winners shouting "bingo" is specifically exempt from tax under IRC 513(f) and regulations Section 1.513-5(d) that define what non taxable bingo is. In traditional bingo there is a winner every game. This is not true in video bingo. There is no skill aspect to video bingo; the player is not required to mark his card or call "bingo". Traditional bingo requires a certain degree of attentiveness and skill: listening to the called numbers, marking the card, and shouting "bingo". In video bingo, the player wins if the purchased video printout's numbers match the preselected numbers in a winning pattern.

The majority of ORG's receipts in 20XX were from video bingo and pull-tabs, both taxable activities. Therefore, it appears that ORG was operated for the primary purpose of carrying on an unrelated trade or business.

Donations to charity not commensurate to receipts:

Rev. Rul. 64-182, 1964-1 C.B. 186 determined that an organization whose principal activity is operating tax exempt bingo games may nevertheless qualify for exemption, provided it uses the proceeds of that

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business activity in a real and substantial charitable program [such as charitable grant making] commensurate in scope with its financial resources. However, charitable donations of less than 2% of known revenues is not commensurate with ORG's financial resources, especially when over 24% of ORG's revenue went to its officers.

Charitable activities:

Giving holiday turkeys to bingo players is not a charitable activity as bingo players in general are not members of a charitable class.

Giving money to a social welfare or fraternal organization such as the _____ is not a charitable donation. Such organizations [IRC 501(c)(4) through 20) may be tax exempt, but funding them is not a charitable donation.

Opening the bingo hall once or twice a year for events is not in itself a charitable activity. The events' 501(c)(3) purposes must be substantiated. A canned food drive for a local soup kitchen could be considered a charitable activity if the soup kitchen is shown to be a 501(c)(3) organization.

Private Benefit:

T.R. Section 1.501(c)(3)-1(d)(ii) states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

In the year under examination, 20XX, over half the organization's expenses were paid to a limited liability corporation (CO-10) owned 50% by another limited liability corporation (CO-12) owned 100% by ORG's officers.

Via these multiple entities, ORG's president, President; vice-president, Vice-President; and secretary, Secretary, received approximately \$ or \$ each.

In addition, each received directly from ORG \$ in compensation and \$ to \$ in contributions to employee benefit plans for a total benefit derived from ORG of at least \$ each.

This \$ (\$ x 3 ORG officers) in personal benefits is considerably more than the unsubstantiated \$ in charitable contributions reported by ORG during the year. Even if the \$ amount is correct, it represents less than 2% of the net receipts taken in by ORG during the year whereas the personal benefits amount is over 24% of net receipts.

Taxpayer's Position:

ORG believes that it did not pay CO-10 a 50% fee, but ORG agrees to revocation of its tax exempt status as of January 1, 20XX. ORG will file Forms 1120 for 20XX, 20XX, 20XX, and 20XX in June, 20XX.

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Conclusion:

ORG does not engage primarily or even substantially in activities which accomplish one or more of the exempt purposes specified in IRC 501(c)(3).

ORG provides an insubstantial public benefit as less than 2% of its receipts are donated to charitable causes and less than 1% of its activities promote charitable causes. However, a substantial purpose was providing fees to the officers' limited liability corporation (24% of its receipts) and providing bingo and pull tab games to the public (over 99% of its activities).

Based on ORG's activities and percentage of charitable contributions, ORG does not meet the requirements for exemption under IRC 501(c)(3) and its exempt status is being revoked effective the first day of the year under examination, January 1, 20XX.

Alternative Issues:

In the alternative, if the organization qualifies for continued exemption under IRC 501(c)(3), whether the income from the sale of pull-tabs, video bingo games, and miscellaneous bingo gear such as daubers and hats, should be taxed as unrelated business income under IRC 511? whether penalties apply to the late filing of Forms 990-T, Exempt Organization Business Income Tax Return?

Facts:

ORG [ORG] has unrelated business taxable income and should be filing Forms 990-T, Exempt Organization Business Income Tax Return.

ORG has never filed a Form 990-T.

In response to the Internal Revenue Service's Determination's request for further information and clarification in a phone conversation on October 28, 19XX, President and Secretary (then Secretary) wrote to the IRS in a letter of the same date, among other statements:

I did not understand until our conversation that pull tab income and bingo income should be kept separate [sic]. We estimated 5% of our gross income was from pull tabs... We will keep pull tab income from this day on separate[sic] from bingo income...I understand that we will be taxed on the pull tab income.

Law:

IRC Section 512(a)(1) defines the term "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business.

IRC Section 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt purposes.

IRC Section 513(a)(1) provides that the term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

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IRC Section 513(f) provides that the term "unrelated trade or business" does not include the conduct of certain bingo games.

IRC Section 513(f)(2) defines "bingo games" as any game of bingo of a type in which usually the wagers are placed, the winners are determined, and the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game, the conducting of which is not an activity ordinarily carried out on a commercial basis, and the conducting of which does not violate any State or local law. Section 1.513-1(e)(1) of the Income Tax Regulations provides for exceptions to section 513(a) of the Code, including any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.513-5(a) of the regulations provides that, under section 513(f) of the Code, and subject to the limitations in paragraph (c) of this section, in the case of an organization subject to the tax imposed by section 511, the term "unrelated trade or business" does not include any trade or business that consists of conducting bingo games as defined in paragraph (d) of this section).

Section 1.513-5(c)(1) of the regulations provides that paragraph (a) of this section shall not apply with respect to any bingo game conducted in violation of State or Local law.

Section 1.513-5(d) of the regulations defines a bingo game as

A game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wages are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wages in that game. The term "bingo game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

IRC section 6651 (a) imposes a penalty for failure to file a tax return by the date prescribed, unless it is shown that the failure is due to reasonable cause. The failure to file penalty is 5% of the tax due per month, or fraction thereof, with a maximum penalty of 25%.

IRC 6662 imposes a 20% negligence penalty on the underpayment of tax if such underpayment is due to (1) negligence or disregard of rules or regulations.

Government's Position:

The sale of pull tabs, video bingo games, and bingo gear is not exempt from unrelated business taxable income and is subject to tax.

Traditional paper bingo, with numbers being called and winners shouting "bingo" is specifically exempt from tax under IRC 513 and the related regulations that define what non taxable bingo is. In traditional bingo there is a winner every game. This is not true in video bingo. There is no skill aspect to video bingo; the player is not required to mark his card or call "bingo". Traditional bingo requires a certain degree of attentiveness and skill: listening to the called numbers, marking the card, and shouting "bingo". In video bingo, the player wins if the purchased video printout's numbers match the preselected numbers in a winning pattern.

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Pull tabs, bingo gear, and video bingo do not meet the description of tax exempt bingo at Section 1.513-5(d) of the regulations.

Secretary has calculated pull tab sales for all years 19XX through 20XX. Video bingo sales amounts can be calculated by doubling the 50% of gross receipts paid to the video bingo hardware/software providers.

As evidenced by its letter to the IRS of October 28, 19XX, ORG was aware that pull tab income was taxable. Therefore the organization has no reasonable cause for not filing Forms 990-T within the time prescribed by law and is subject to the failure to file penalty under IRC 665(a)(1) and 6601(e)(2). A penalty of 5% is added to the tax for each month or part of a month for which the Form 990-T is late. The penalty will not exceed a total of 25 per cent.

Knowing that pull tab income was taxable, the Corporation did not make a reasonable attempt to comply with the provisions of the Internal Revenue Code or to exercise ordinary and reasonable care in the preparation of an income tax return. Therefore, ORG is subject to the negligence penalty of IRC 6662, adding to the tax due an amount equal to 20 percent of the underpayment of tax.

Taxpayer's Position:

ORG forgot it was supposed to pay tax on pull tabs and did not realize that video bingo was taxable.

Conclusion:

ORG must file Forms 990-T, reporting pull tab, video bingo, and bingo gear sales as income.

ORG should be assessed the failure to file penalty and any underpayment is subject to the negligence penalty.

Internal Revenue Service

Department of the Treasury

Internal Revenue Service
Exempt Organizations
1244 Speer Blvd., suite 442
Denver, Colorado 80204

Date:

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Exams

Enclosures:
Publication 892
Publication 3498
Report of Examination